Legislative Audit Division

State of Montana

Report to the Legislature

November 2003

Financial Audit

For the Fiscal Year Ended June 30, 2003

Montana Guaranteed Student Loan Program

Commissioner of Higher Education

We performed a financial audit of the Montana Guaranteed Student Loan Program for the fiscal year ended June 30, 2003. This report contains the audited financial statements and accompanying notes for fiscal year 2002-03. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

This is an annual financial audit performed to attest to the fairness of the financial statements of the Montana Guaranteed Student Loan Program. Audit recommendations, if any, identified during this financial audit will be included in the biennial financial-compliance audit of the Office of the Commissioner of Higher Education.

Direct comments/inquiries to:
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

03-06

Help eliminate fraud, waste, and abuse in state government. Call the Fraud Hotline at 1-800-222-4446 statewide or 444-4446 in Helena.

FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2003, will be issued by March 31, 2004. The Single Audit Report for the two fiscal years ended June 30, 2001, was issued on March 26, 2002. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

November 2003

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 2002-03 financial audit of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program (MGSLP). The objectives of a financial audit include determining if the program's financial statements present fairly its financial position at June 30, 2003, and the results of its operations for the fiscal year then ended. We tested compliance with state and federal laws that have a direct and material impact on the financial statements. Additional compliance testing for the program is included in our biennial financial-compliance audit of the Office of the Commissioner of Higher Education.

The MGSLP was authorized by the Montana legislature in 1979 and established July 1, 1980. The MGSLP allows eligible students to receive loans from lending institutions to pay for post-secondary education. The federal government guarantees the loans made by lending institutions and makes administrative cost reimbursements to the MGSLP for acting as a collection agent. The MGSLP performs the administrative duties associated with the loan guarantee process but contracts with an outside vendor for computer support services.

As of June 30, 2003, the original principal balance of guaranteed loans outstanding was approximately $796,352,698, with a default rate of 1.78 percent for federal fiscal year 2002-03. Given the current default rate, the federal government will reimburse MGSLP 98 to 100 percent for loans issued prior to October 1, 1998, and 95 percent for loans issued on or after October 1, 1998. The change in reimbursement percentages was the result of changes made by the federal government.

Beginning on page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion, which means the reader can rely on the presented information. The MGSLP's response to our audit is on page B-1.

We thank the Commissioner of Higher Education, the Director of MGSLP, and their staff for the cooperation and assistance they provided during the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Room 160, State Capitol Building PO Box 201705 Helena, MT 59620-1705
Phone (406) 444-3122 FAX (406) 444-9784 E-Mail lad@state.mt.us

Office of the Commissioner of Higher Education	Sheila M. Stearns, Ed.D.	Commissioner of Higher Education
	Roger Barber	Acting Deputy Commissioner for Academic and Student Affairs
	Rod Sundsted	Associate Commissioner for Fiscal Affairs
	Laurie O. Neils	Director of Budget and Accounting
Montana Guaranteed Student Loan Program	Bruce Marks	Director
	Karen Wing	Fiscal Manager and Financial Analyst

For additional information concerning the Montana Guaranteed Student Loan Program, contact Bruce Marks, Director, at:

PO Box 203101
Helena MT 59620-3101
(406) 444-6594

e-mail address: bmarks@mgslp.state.mt.us

Members of the audit staff involved in this audit were Geri Hoffman, Sonia Powell, and Jennifer Solem.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheet of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program – Federal Special Revenue Fund of the state of Montana as of June 30, 2003, and the related Statement of Revenues, Expenditures, and Changes in Fund Balance Budget and Actual for the fiscal year then ended. The information contained in these financial statements is the responsibility of the program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Commissioner of Higher Education's Montana Guaranteed Student Loan Program – Federal Special Revenue Fund. They do not purport to, and do not, present fairly the financial position and results of operations of the state of Montana, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program – Federal Special Revenue Fund of the state of Montana as of June 30, 2003, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

October 3, 2003

Room 160, State Capitol Building PO Box 201705 Helena, MT 59620-1705
Phone (406) 444-3122 FAX (406) 444-9784 E-Mail lad@state.mt.us

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Federal Special Revenue Fund
Balance Sheet
As of June 30, 2003

	Agency Operating Fund	Federal Student Loan Reserve Fund	Essay Scholarship Fund
Assets			
Cash in Treasury	$ 218,834	$ 1,379,117	$ -
Short Term Investments (Note 2)	2,800,000	3,545,212	-
Accounts Receivable	257,110	11,236	-
Due From Federal Government (Note 3)	240,763	1,182,361	-
Long Term Investments (Note 4)	-	-	71,216
Prepaid Expense	27,039	-	-
Total Assets	$ 3,543,746	$ 6,117,926	$ 71,216

Liabilities and Fund Balance

	Agency Operating Fund	Federal Student Loan Reserve Fund	Essay Scholarship Fund
Liabilities			
Accounts Payable	$ 276,911	$ 67,449	$ -
Property Held in Trust (Note 5)	178,722	-	-
Due to Federal Government (Note 6)	-	298,365	-
Total Liabilities	$ 455,633	$ 365,814	$ -
Total Fund Balance (Note 7)	3,088,113	5,752,112	71,216
Total Liabilities and Fund Balance	$ 3,543,746	$ 6,117,926	$ 71,216

The accompanying notes are an integral part of this financial statement.

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Federal Special Revenue Fund
Statement of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual
For the Period July 1, 2002 - June 30, 2003

	Agency Operating Fund			Federal Student Loan Reserve Fund			Essay Scholarship Fund		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
Revenue									
Guarantee Fee Income (Note 8)	$ -	$ -	$ -	$ 900,000	$ 932,042	$ 32,042	$ -	$ -	$ -
Loan Processing and Issuance Fee (Note 9)	520,000	618,445	98,445	-	-	-	-	-	-
Account Maintenance Fees (Note 10)	750,000	829,175	79,175	-	-	-	-	-	-
Default Aversion Fees (Note 11)	400,000	433,115	33,115	-	-	-	-	-	-
Collection Recoveries and Rehabilitations (Note 12)	4,600,000	5,266,131	666,131	-	-	-	-	-	-
FFELP Consolidation Collections (Note 12)	500,000	17,786	(482,214)	-	-	-	-	-	-
FDSLP Consolidation Collection Fees (Note 12)	2,500,000	1,228,591	(1,271,409)	-	-	-	-	-	-
Reinsurance from Department of Education (Note 13)	-	-	-	24,425,000	16,175,684	(8,249,316)	-	-	-
Non-Reinsured Loan Recoveries (Note 16)	-	-	-	47,000	94,225	47,225	-	-	-
Disbursement Service Fees (Note 5)	98,650	116,106	17,456	-	-	-	-	-	-
Investment Earnings (Note 2 and Note 4)	106,000	20,734	(85,266)	460,000	93,483	(366,517)	-	4,716	4,716
Miscellaneous	18,000	9,497	(8,503)	-		-	-		-
Total Revenue	9,492,650	8,539,580	(953,070)	25,832,000	17,295,434	(8,536,566)	0	4,716	4,716
Expenditures									
Administrative Costs	$ 5,510,092	$ 4,367,959	$ 1,142,133	$ -	$ -	$ -	$ -	$ -	$ -
Cost of Loan Collections (Note 12)	$ 4,142,992	$ 3,854,198	$ 288,794	-	-	-	-	-	-
Claims Paid to Lenders (Note 13)	-	-	-	24,783,714	16,553,094	8,230,620	-	-	0
Default Aversion Fees (Note 11)	-	-	-	481,634	433,115	48,519	-	-	0
Account Maintenance Fee Expense (Note 10)	-	-	-	-	114,415	(114,415)	-	-	0
Total Expenditures	9,653,084	8,222,157	1,430,927	25,265,348	17,100,624	8,164,724	0	0	0
Excess (Deficiency) of Revenues Over Expenditures	(160,434)	317,423	477,857	566,652	194,810	(371,842)	-	4,716	4,716
Extraordinary Expense: Recall of Federal Reserve Funds (Note 14)	-	-	-	0	(5,684,643)	(5,684,643)	0	0	-
Fund Balance 06/30/02	2,016,844	2,016,844	-	12,062,291	12,062,291	-	-	-	-
Transfer of Interest Earned on Reserve Recall (Note 15)	-	820,346	820,346	0	(820,346)	(820,346)	0	-	-
Transfer of asset for Scholarship Fund (Note 4)		(66,500)	(66,500)	-	-	-		66,500	66,500
Fund Balance 06/30/03	$1,856,410	$ 3,088,113	$ 1,231,703	12,628,943	$ 5,752,112	$ (6,876,831)	-	$ 71,216	$ 71,216

The accompanying notes are an integral part of this financial statement

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Federal Special Revenue Fund
Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Program

The State of Montana's Guaranteed Student Loan Program (MGSLP) is located in the Office of the Commissioner of Higher Education. MGSLP was established by the Office of the Commissioner of Higher Education in fiscal year 1981 to coordinate and administer the federally insured student loans issued by various lending institutions. Montana's Federal Family Education Loan Program (FFELP) operates in compliance with and pursuant to agreements between the Montana Board of Regents and the U.S. Department of Education (DE), pursuant to Section 428 of the Higher Education Act of 1965, as amended.

B. Basis of Accounting

The financial statements were prepared using the modified accrual basis of accounting, and are presented in a budget to actual format, which does not significantly differ from a GAAP presentation. Under the modified accrual basis of accounting, expenditures are recorded on the basis of valid obligations. Revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available to finance expenditures of the fiscal period or are not received at the normal time of receipt. Revenues are considered to be available if they are collectable within the current time period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. The budget information presented in the Statement of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual is as approved by the Montana Board of Regents for fiscal year 2003.

C. Descriptions of Funds

As a Federal Special Revenue Fund, MGSLP accounts for the proceeds of revenue sources that are legally restricted to expenditures for specified purposes. Pursuant to the Higher Education Act of 1965, as amended, MGSLP accounts for its operations in two separate funds: the Federal Student Loan Reserve Fund (FSLRF) and the Agency Operating Fund (AOF). Use of the FSLRF is limited to payment of lender claims and payment of default aversion fees or other DE fee payments as directed. MGSLP is required to deposit claim reimbursements from DE into the FSLRF, as well as the following: DE's equitable share of defaulted loan recoveries, the portion of default recoveries that equals the complement of the reinsurance rate which is not reimbursed to MGSLP by DE, and student loan insurance premiums (guarantee fees). The AOF is the property of MGSLP, and is used for a variety of FFELP activities and for other student aid related activities as selected by the agency. Payments received by MGSLP for loan processing and issuance, account maintenance, default aversion activities, and MGSLP's share of defaulted loan collections is all deposited into the AOF. MGSLP also maintains a fund to account for funds held in trust for recipients of MGSLP's essay scholarship contest. All funds are invested in certificates of deposit of varying maturity dates with the Montana Family Education Savings Program.

2. SHORT TERM INVESTMENTS

Short Term Investments are units purchased in the State of Montana's Short Term Investment Pool (STIP) and are reflected at cost, which equals market. At June 30, 2003, MGSLP owned 6,345,212 units valued at $1 per unit for a total of $6,345,212. During fiscal year 2003, MGSLP had STIP investment earnings of $102,050. STIP securities include Banker's Acceptances, Commercial Paper, Corporate Obligations, Montana Certificates of Deposit, Government Securities, and Repurchase Agreements. At June 30, 2003, most securities, classified as Risk

Category 1, were held by the state or its agent in the state's name. The remaining portions not classified were loaned under a security lending agreement with the state's agent.

Asset-backed securities have less credit risk than securities not backed by pledged assets and market risk for these securities is the same as market risk for similar non asset-backed securities. While variable-rate securities have credit risk identical to similar fixed-rate securities, their market risk is more sensitive to interest rate changes. Market risk may be less volatile than fixed-rate securities because the value of variable-rate securities will usually remain at or near par. There are no legal risks that the Board of Investments is aware of regarding any STIP investments.

According to the Governmental Accounting Standards Board (GASB) Statement No. 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools, STIP is considered an external investment pool. An external investment pool is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair value to report net assets to compute unit values. The Board of Investments has adopted a policy to treat STIP as a 2a7-like pool.

3. DUE FROM FEDERAL GOVERNMENT

MGSLP pays individual lending institutions for any loans that have defaulted or are unpaid due to the death, permanent disability, or bankruptcy of the borrower. The agency then seeks reimbursement from the DE in accordance with reinsurance agreements between the agency and DE. Claim payments and subsequent reinsurance payments are paid from and deposited into the Federal Student Loan Reserve Fund. MGSLP's claims for reinsurance payments not received as of June 30, 2003, are included here.

In addition, the receivable Due From Federal Government includes amounts MGSLP had not yet received for Loan Processing and Issuance Fees (Note 9) and Account Maintenance Fees (Note 10) for the last quarter of fiscal year 2003. The extent of the outstanding reinsurance activity and other pending reimbursements from DE as of June 30, 2003, is shown below.

Reinsurance Claims	$1,182,361	Federal Student Loan Reserve Fund
Account Maintenance Fee	$200,989	Agency Operating Fund
Loan Processing and Issuance Fee	$39,774	Agency Operating Fund
Total Due From Federal Government	$1,423,124	

4. LONG TERM INVESTMENTS

MGSLP maintains an account with the Montana Family Education Savings Program for funds held in trust for recipients of MGSLP's essay scholarship contest. All funds are invested in certificates of deposit of varying maturity dates. During fiscal year 2003, MGSLP recorded investment earnings from these certificates of deposit of $4,716.

5. PROPERTY HELD IN TRUST

MGSLP operates an escrow disbursement service for approximately forty lenders. Participating lenders are assessed a fee for this service. In accordance with contracts MGSLP has with the disbursement service lenders, MGSLP automatically debits the lenders' accounts to collect loan proceeds. MGSLP then disburses funds to the schools for delivery to the students either by individual State of Montana warrants or electronic transfers. The MGSLP disbursement service records all adjustments to individual student loan accounts and ensures that school refunds of

loan proceeds are promptly returned to the lenders. As of June 30, 2003, MGSLP's disbursement service held $178,722 in student loan funds that are to be refunded to lenders after June 30, 2003. Disbursement service revenues earned during fiscal year 2003 were $116,106.

6. DUE TO FEDERAL GOVERNMENT

After assignment to the guaranty agency, MGSLP seeks collection of student loans that have defaulted. A portion of the recoveries of loans reinsured by the Department of Education (DE) is owed back to DE (Note 12). At June 30, 2003, the amount owed to DE was $298,365.

7. FUND BALANCE

The agency is authorized to use the investment earnings from the restricted account (Note 14 and Note 15) to perform certain default reduction activities, as outlined in the Balanced Budget Act of 1997. As of June 30, 2003, the unspent portion of investment earnings in the Agency Operating Fund was $820,346. This amount is currently classified as "designated" for those federally regulated specific purposes in the statewide accounting system.

8. GUARANTEE FEE INCOME

Guarantee fees are received from borrowers at the time loans are disbursed. As of July 1, 1994, the maximum guarantee fee that borrowers may be charged is 1% of the loan amount.

During fiscal year 2003, MGSLP charged a guarantee fee of 1%. The fees are deposited into the Federal Student Loan Reserve Fund (FSLRF), and recognized as revenue upon receipt. Guarantee fee revenue for fiscal year 2003 was $932,042.

9. LOAN PROCESSING AND ISSUANCE FEE

The Higher Education Amendments of 1998 authorized payment of a Loan Processing and Issuance Fee beginning October 1, 1998. Under this Act, each guaranty agency is paid a loan processing and issuance fee, to be deposited into the Agency Operating Fund, equal to .65% of the total principal amount of loans originated during federal fiscal years 1999-2003 on which the agency issued insurance. Beginning in federal fiscal year 2004, for loans guaranteed on or after October 1, 2003, the fee will drop to .40%. During fiscal year 2003, Loan Processing and Issuance Fee revenue totaled $618,445, which includes $39,774 accrued for reimbursements that were not received until after June 30, 2003.

10. ACCOUNT MAINTENANCE FEE

The Higher Education Amendments of 1998 authorized the payment of an Account Maintenance Fee beginning October 1, 1998. Under this Act, each guaranty agency is paid an account maintenance fee, to be deposited into the Agency Operating Fund. For federal fiscal years 2001 through 2003, the fee is .10% of the original principal balance of guaranteed loans outstanding during the year. During fiscal year 2003, Account Maintenance Fee revenue totaled $829,175, of which $114,415 was authorized for payment from the Federal Student Loan Reserve Fund by the Department of Education.

11. DEFAULT AVERSION FEE

The Higher Education Amendments of 1998 authorized the payment of a Default Aversion Fee beginning October 1, 1998. Upon receipt of a completed lender request for assistance (LRA) not earlier than the 60th day of delinquency, a guaranty agency must engage in default aversion activities designed to prevent a default by the borrower Department of Education Regulations provide for payment of a fee equal to 1% of the loan balance at the time an LRA is submitted, regardless of whether or not the loan is brought current. The default aversion fees are to be transferred from the Federal Student Loan Reserve Fund (FSLRF) to the Agency Operating Fund (AOF) no more frequently than monthly. If the agency receives a default aversion fee and the account later defaults, the agency must rebate 1% of the claim amount to the FSLRF. The fee

may be paid only once on any loan. During fiscal year 2003, net Default Aversion Fee revenue and expense, for the AOF and FSLRF respectively, was $433,115.

12. COLLECTION COSTS RETAINED

MGSLP pursues collection, from the borrower or other responsible party, of defaulted loans held by the agency. The U.S. Secretary of Education is entitled to his equitable share of any recoveries, as determined by the rate of reinsurance on the defaulted loans less an allowance for collection cost reimbursement. Beginning October 1, 1998, the Higher Education Amendments of 1998 authorize guaranty agencies to deposit an amount equal to 24% of the payments made by or on behalf of a defaulted borrower into its Agency Operating Fund. Beginning October 1, 2003, the amount will be reduced to 23%. In addition, the Secretary provides the agency with collection costs amounting to 18.5% of the outstanding balance of any defaulted loan held by the agency which is consolidated by the borrower into a Federal Consolidation Loan through either Federal Family Education Loan Program (FFELP) consolidation or Federal Direct Student Loan Program (FDSLP) consolidation. During fiscal year 2003, MGSLP retained $2,658,310 in net collection costs from loan recoveries and consolidations, as follows.

	Revenues	Expenses	Net
Collection Recoveries and Rehabilitations	$5,266,131	$3,839,188	$1,426,943
FFELP Consolidations	$17,786	$15,010	$2,776
FDSLP Consolidations	$1,228,591	$0	$1,228,591
Total	$6,512,508	$3,854,198	$2,658,310

13. CLAIMS PAID TO LENDERS AND REINSURANCE FROM DEPARTMENT OF EDUCATION

MGSLP records amounts paid to lenders for claims and subsequent amounts received from the Department of Education (DE) as expenses and revenues respectively. For fiscal year 2003, MGSLP paid claims totaling $16,553,094 and received reinsurance from DE totaling $16,175,684.

14. RECALL OF FEDERAL RESERVES

The Balanced Budget Act of 1997, P.L. 105-33, signed August 5, 1997, provided for the U.S. Secretary of Education to recall $1 billion of guaranty agencies' reserve funds on September 1, 2002. Each agency's required share of the total recalled reserve funds was calculated based on the total reserve fund dollars held by the agency as of September 30, 1996. For purposes of calculation, the reserves include any Federal reserve funds in cash or liquid assets held by the agency. The reserve ratio is defined as the amount of the agency's federal reserve fund as of September 30, 1996, divided by the original principal amount of all outstanding insured loans on that date. In each of the federal fiscal years 1998 through 2002, each guaranty agency was required to transfer its required share, in equal annual installments, into a restricted account established by the agency, where funds would be held until final transfer to the Department of Education (DE) on September 1, 2002. Once deposited into the restricted account, an agency could not use the funds for any purpose without the express written permission of the Secretary, except that the agency could use the investment earnings from the restricted account to perform certain default reduction activities, as outlined in the Balanced Budget Act of 1997. At the end of the five-year period, the reserve funds in the restricted account were to be transferred to DE with a corresponding reduction in net assets. MGSLP's required share of the total recalled reserves is $5,290,229 (approximately 65% of MGSLP's available reserve balance at September 30, 1996).

The Higher Education Amendments of 1998 required the Secretary to recall from guaranty agency federal student loan reserve funds a total of $85 million, $82.5 million, and $82.5 million in each of federal fiscal years 2002, 2006, and 2007 respectively. As of August 28, 2002, DE had made a final determination of MGSLP's share of the total amounts to be recalled for federal fiscal

year 2002 at $394,414. Depending upon its fund balance at the time, MGSLP may be liable for additional recall amounts in federal fiscal years 2006 and 2007 in the amounts of $382,814 and $382,813 respectively.

The total of the above recall amounts, $5,684,643, was transferred to the Department of Education on August 30, 2002 and has been classified as an extraordinary expense for fiscal year 2003.

15. TRANSFER OF INTEREST EARNED ON RESERVE RECALL

During fiscal year 2003, the Department of Education (DE) allowed guaranty agencies to transfer any unspent recall interest earned (Note 14) during the current and prior fiscal years from the Federal Student Loan Reserve Fund to the Agency Operating Fund. The total amount transferred during fiscal year 2003 was $820,346.

16. CONTINGENCIES

The original principal balance of guaranteed loans outstanding held by MGSLP as of June 30, 2003, was approximately $796,352,698. This amount excludes bad debt, death, disability, and bankruptcy claims which have been previously purchased by the agency. MGSLP has entered into agreements with the Department of Education (DE), dated June 13, 1980, for reinsurance and supplemental reinsurance of loans, in accordance with the Higher Education Act of 1965, as amended. These agreements allow for 100% reimbursement by DE for claims due to the death, disability, or bankruptcy of the borrower. Claims due to defaulted loans may be reimbursed by DE for up to 100%. The percent of reimbursement on defaulted loans payable to the agency is dependent upon MGSLP's annual default rate and date of the loan's first disbursement. Annual default rates are calculated as the ratio of year-to-date default purchases divided by the original guaranteed amount of loans in repayment status at the beginning of the federal fiscal year. The following schedule reflects the federal reinsurance rates on defaulted student loans. In the event of extreme future adverse loss experience, MGSLP could be liable for up to 25% of the outstanding loan volume. Since its inception, MGSLP has paid $2,192,145 in claims, or portions of claim eligible loans, which were not reinsured by DE. During fiscal year 2003, MGSLP recovered $94,225 of the total outstanding balance of non-reinsured claims held by the agency.

RATE OF ANNUAL DEFAULTS	**FEDERAL REINSURANCE On loans made prior to 10/01/93**	**FEDERAL REINSURANCE On loans made on or after 10/01/93 and prior to 10/01/98**	**FEDERAL REINSURANCE On loans made on or after 10/01/98**
Less than 5%	100%	98%	95%
5% or greater but less than 9%	90% of claims 5% or greater but less than 9%	88% of claims 5% or greater but less than 9%	85% of claims 5% or greater but less than 9%
9% or greater	80% of claims 9% or greater	78% of claims 9% or greater	75% of claims 9% or greater

17. COMMITMENTS

MGSLP is bound by Guarantee Reserve Agreements with the lending institutions participating in the Federal Family Education Loan Program in Montana. These agreements require MGSLP to maintain an amount in the guarantee reserve fund equal to at least 0.25% of the unpaid principal balance of all outstanding loans guaranteed by the agency.

The Guarantee Reserve Agreement ensures that MGSLP will have sufficient cash available to carry out its reasonably expected obligations on guaranteed claim eligible student loans. As of June 30, 2003, MGSLP was in compliance with all Guarantee Reserve Agreements.

18. FIXED ASSETS

MGSLP is accounted for on the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) as a federal special revenue fund. The fixed assets of MGSLP, which are included in the Government-wide financial statements of the state of Montana, are valued at cost and total $63,648 as of June 30, 2003.

19. COMPENSATED ABSENCES LIABILITY

MGSLP's liability for compensated absences, which totals $170,481 as of June 30, 2003, is included in the Government-wide financial statements of the state of Montana.

20. LEASES

MGSLP has entered into an operating lease for office facilities. The operating lease, which expires in December 2014, had total rental payments during fiscal year 2003 of $152,623. Future minimum lease payments under the lease agreement as of the end of the fiscal year are as follows:

FY Ending June 30	Operating Lease
2004	$140,531
2005	$141,034
2006	$140,812
2007	$140,362
2008	$139,203
2009	$57,664

21. RELATED PARTY TRANSACTIONS

The Montana Board of Regents, which governs MGSLP, guarantees loans owned by the Montana Higher Education Student Assistance Corporation (MHESAC). The Board of Regents and MHESAC have four common board members. Approximately 59.31% of MGSLP's outstanding loan volume is held by MHESAC. The Board of Regents and SAF have four common board members.

MGSLP also has an agreement with Student Assistance Foundation of Montana (SAF) to share certain costs for the lease of computer equipment; computer and software maintenance costs; and personnel costs for employees of SAF who perform services that are of direct benefit to MGSLP. Certain SAF personnel are authorized to purchase computer equipment for use by both MGSLP and SAF. Costs for these purchases are covered under an agreement for services between the two entities. During fiscal year 2003, MGSLP's portion of shared costs reimbursed to SAF was $500,236.

MGSLP also receives certain services from the State of Montana for telephone, postage, and computer supplies that directly benefit SAF. SAF reimburses MGSLP for these services. During fiscal year 2003, MGSLP was reimbursed for $214,535 of shared costs by SAF.

22. EMPLOYEES' RETIREMENT SYSTEM

MGSLP classified employees are covered by the Public Employees' Retirement System (PERS) or the Teachers' Retirement System (TRS). Professional employees with contracts under the authority of the Board of Regents are covered by the Optional Retirement Program (ORP), which is available through the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) unless they were previously members of the TRS, in which case they may

choose to enter the TRS. The classified staff is provided a retirement program through the Montana Public Employees' Retirement System (PERS).

Defined Benefit Plans

Public Employees' Retirement System (PERS)
Established in 1945 and governed by Title 19, chapter 2 & 3, MCA, PERS participants are eligible to retire at age 60 with at least five years of service; at age 65 regardless of length of service; or at 30 years of service regardless of age. A reduced retirement benefit may be taken with 25 years of service or at age 50 with a minimum of five years of service. Effective January 1, 1989, monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals five years. Under PERS, MGSLP contributes 6.900% of an employee's gross wages. The employee contributes 6.900% of his/her gross wages.

Teachers' Retirement System (TRS)
Established in 1937 and governed by Title 19, chapter 20, MCA, TRS participants are eligible to retire with a minimum 25 years of membership service or five years of creditable service at age 60. A retirement benefit is 1/60 times the years of service times average final compensation. An employee is vested in TRS following completion of five years of creditable service. Vested employees may retire at or after age 50 and receive a reduced retirement benefit. Under TRS, MGSLP contributes 7.470% of an employee's gross wages. The employee contributes 7.150% of his/her gross wages.

Defined Contribution Plan

Optional Retirement Program (ORP)
Established in 1988 and underwritten by TIAA-CREF, the ORP is a defined contribution plan. Contribution rates for the plan are required and determined by state law. The state's contributions were equal to the required contribution. The benefits at retirement depend upon the amount of contributions, amounts of investment gains and losses and the employee's life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. MGSLP records employee/employer contributions and remits monies to TIAA-CREF. Individuals are immediately vested with contributions. Under ORP, MGSLP contributes 4.956% of an employee's gross wages. The employee contributes 7.044% of his/her gross wages. In addition, a total of $2,283 or 4.04% was contributed to TRS from ORP employer contribution to amortize past service unfunded liability in accordance with state law.

The state's policy is to fund accrued pension costs although unfunded liabilities exist. Based on their most recent actuarial valuation reports, the PERS and TRS were actuarially sound.

Trend information, indicating the progress made toward accumulating assets needed to pay retirement benefits when they are due, is not available on an agency basis. This information is available on a statewide basis in the Retirement Systems' annual reports.

Retirement plan information for MGSLP as of June 30, 2003, is as follows.

	PERS	TRS	ORP
Covered Payroll	$1,268,855	$71,635	$49,018
Total Payroll	$1,389,508	$1,389,508	$1,389,508
Employer Contributions	$87,551	$19,267	$4,792
Percent of Covered Payroll	6.900%	7.470%	4.956%
Employee Contribution	$87,551	$5,122	$3,453
Percent of Covered Payroll	6.900%	7.150%	7.044%

MONTANA GUARANTEED STUDENT LOAN PROGRAM

Mailing Address:
P.O. Box 203101
Helena, MT 59620-3101
4989

(406) 444-6594
Fax (406) 444-1869
www.mgslp.state.mt.us

Delivery Address:
2500 Broadway
Helena, MT 59601-

Customer Assistance (800) 537-7508

November 13, 2003

RECEIVED
NOV 1 4 2003
LEGISLATIVE AUDIT DIV

Scott Seacat, Legislative Auditor
Room 160, State Capitol
PO Box 201705
Helena, MT 59620-1705

Dear Scott:

Please accept this letter as acknowledgement that we consider the fiscal audit for year 2003 performed by your staff to be completed. We understand the report contains an unqualified opinion of our program's financial statements and that there are no findings or recommendations.

We would like to compliment your staff for their professionalism and courtesy during the audit. It was a pleasure to work with them. As always, the Montana Guaranteed Student Loan Program remains committed to providing access to post-secondary education to the deserving citizens throughout our great state. Those same citizens can take comfort knowing that MGSLP has received an unqualified audit from the Legislative Audit Division.

Once again, thank you for your assistance.

Sincerely,

Bruce Marks
Director, Montana Guaranteed Student Loan Program